APPENDIX A

Internal Revenue Code of 1954:

SEC. 212. EXPENSES FOR PRODUCTION OF INCOME.

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

(1) for the production or collection of income;

(2) for the management, conservation, or maintenance of property held for the production of income; or

(3) in connection with the determination, collection, or refund of any tax.

(26 U.S.C. 1964 ed., § 212)

SEC. 6901. TRANSFERRED ASSETS.

(a) *Method of Collection.*—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, paid and collected in the same manner and subject to the same provisions and limitations as in the case of the taxes with respect to which the liabilities were incurred:

(1) *Income, Estate and Gift Taxes.*—

(A) *Transferees.*—The liability, at law or in equity, of a transferee of property—

* * *

(c) *Period of Limitations.*—The period of limitations for assessment of any such liability of a transferee or a fiduciary shall be as follows:

(1) *Initial Transferee.*—In the case of the liability of an initial transferee, within 1 year after the expiration of the period of limitation for assessment against the transferor;

(2) *Transferee of Transferee.*—In the case of the liability of a transferee of a transferee, within 1 year after

the expiration of the period of limitation for assessment against the preceding transferee, but not more than 3 years after the expiration of the period of limitation for assessment against the initial transferor;

except that if, before the expiration of the period of limitation for the assessment of the liability of the transferee, a court proceeding for the collection of the tax or liability in respect thereof has been begun against the initial transferor or the last preceding transferee, respectively, then the period of limitation for assessment of the liability of the transferee shall expire 1 year after the return of execution in the court proceeding.

* * *

(h) *Definition of Transferee.*—As used in this section, the term "transferee" includes donee, heir, legatee, devisee, and distributee, and with respect to estate taxes, also includes any person who, under section 6324(a)(2), is personally liable for any part of such tax.

(26 U.S.C. 1964 ed., § 6901).

APPENDIX B

IN THE UNITED STATES COURT OF CLAIMS

No. 285-64

(Decided November 9, 1967)

SOUTHERN ARIZONA BANK AND TRUST COMPANY, A CORPORATION, AND PEGGY L. MARTIN, EXECUTORS OF THE ESTATE OF GEORGE MARTIN, DECEASED, AND PEGGY L. MARTIN

v.

THE UNITED STATES

Scott P. Crampton, attorney of record, for plaintiffs. *Korner, Doyle, Worth & Crampton* and *Stanley Worth,* of counsel.

Leonard S. Togman, with whom was *Assistant Attorney General Mitchell Rogovin,* for defendant. *Philip R. Miller,* of counsel.

Before COWEN, *Chief Judge,* LARAMORE, DURFEE, DAVIS, COLLINS, SKELTON and NICHOLS, *Judges.*

Opinion

DAVIS, *Judge,* delivered the opinion of the court:*

The Southern Arizona Bank and Trust Company is an executor of George Martin, an Arizona resident. He and his wife Peggy (who is a co-executor and also a plaintiff in her own right) filed a joint federal income tax return for the calendar year 1961, paid the tax shown, and thereafter paid

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* We are indebted to Trial Commissioner Roald A. Hogenson for his opinion, part of which we have adopted. We reach the same result, on one of the grounds he took, but do not consider other points on which he wrote.

a deficiency of $10,651.02 (plus $756.08 interest) for that year. This action seeks to recover those sums (plus interest). Claim for refund was timely filed and denied, and the same basis for recovery is now asserted. For convenience, George Martin is sometimes called the plaintiff.

In 1961, plaintiff paid attorneys' fees and other legal expenses in the total amount of $23,659.42 in contesting the determination of tax deficiencies of his liquidated Arizona corporation (Crystal Coca-Cola Bottling Company) and the transferee liability of Coca-Cola Bottling Company of Tucson, Inc. (Coca-Cola Bottling), another Arizona corporation. The issue here is whether such expenditures were deductible by Mr. and Mrs. Martin under § 162(a)[1] or § 212(3)[2] of the Internal Revenue Code of 1954.

Plaintiff owned all of the stock of Crystal. In 1955, he sold all of this stock to Samuel E. Gersten and Lawrence D. Mayer, who organized Coca-Cola Bottling to carry on the business of Crystal. As provided in the stock sales

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[1] § 162. Trade or business expenses.

(a) In general.

There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

* * * * * *

[2] § 212. Expenses for production of income.

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

(1) for the production or collection of income;

(2) for the management, conservation, or maintenance of property held for the production of income; or

(3) in connection with the determination, collection, or refund of any tax.

agreement, which was ratified and adopted by the new corporation, plaintiff transferred the Crystal stock to Coca-Cola Bottling which issued its promissory note for $1,450,000 as consideration. As part of the sales agreement, plaintiff agreed that he would indemnify Gersten and Mayer and their new corporation for any taxes owed by Crystal for periods prior to the closing, which occurred November 1, 1955, and it was further agreed that amounts paid by the buyers for these tax claims could at their election be collected from plaintiff or deducted from payments due him, provided, however, that plaintiff would first have the right to contest or litigate at his own expense any such claim in the name of the old or the new company.

Pursuant to the terms of the stock sales agreement, Crystal was liquidated and its assets transferred to Coca-Cola Bottling, effective November 1, 1955. Thereafter, the Internal Revenue Service issued to Coca-Cola Bottling a statutory notice of transferee liability, asserting that Crystal owed income taxes and excess profits taxes in the amount of $117,057.46 for its tax years 1951 through 1955. Under the indemnity clause of the stock sales agreement, plaintiff contested this determination of deficiencies and transferee liability in the name of Coca-Cola Bottling. In the Tax Court of the United States the parties filed a written agreement, specifying how the amounts of the determined deficiencies would be adjusted and computed if transferee liability were sustained. After a hearing, the Tax Court decided that Coca-Cola Bottling was liable as transferee for Crystal's tax deficiencies, which were redetermined in the amount of $50,872.16. This decision was upheld by the Ninth Circuit. *Coca-Cola Bottling Co. of Tucson* v. *Commissioner*, 37 T.C. 1006 (1962), *affirmed*, 334 F. 2d 875 (C.A. 9, 1964).

In connection with the prosecution of that case, plaintiff in 1961 paid $23,659 42 for legal and accounting services, witness expenses, and printing costs. A deduction for this

amount was taken in the 1961 federal income tax return, which, as already noted, was disallowed by the Internal Revenue Service, and a statutory notice of deficiency issued, after an adjustment for the gain to be reported.

Plaintiffs argue that since the litigation of the *Coca-Cola Bottling* case resulted in a decrease from $117,057.46 to $50,872.16 of the income tax deficiencies of Crystal, Mr. Martin was amply justified in incurring the legal expenses here involved,[3] and in deducting them either under § 162(a), or, more specifically, under § 212(3), as "ordinary and necessary expenses paid * * * during the taxable year * * * in connection with the determination * * * of any tax."

Our writing task is simplified by the plaintiffs' correct concession that they are not entitled to recover unless the Martins are first found to have been the transferees of Crystal or of Crystal's transferee, Coca-Cola Bottling.[4] The answer to that threshold issue we find wholly dispositive. On this record we must conclude that the Martins have not been shown to have been such transferees.

This is the kind of case in which the determination whether one is a transferee depends primarily on the law of the particular state. "The extent to which taxpayers are liable, as transferees, for the income taxes of a transferor-corporation is determined by substantive state law."

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[3] No contention is made that the legal expenditures were unreasonable in amount.

[4] When § 212(3) refers to "any tax", it means the individual's own tax or a tax for which he is legally liable to the Government. See *United States* v. *Davis*, 370 U.S. 65, 74-75 (1962); *Carpenter* v. *United States*, 168 Ct. Cl. 7, 10-12, 338 F. 2d 366, 368-69 (1964); *Id.* at 14-17, 338 F. 2d at 370-72 (dissenting opinion); and the reports of the Congressional committees on the change which became § 212(3): H. Rep. No. 1337, 83d Cong., 2d Sess., pp. 29, A 59; S. Rep. No. 1622, 83 Cong., 2d Sess., pp. 34, 218, reprinted in 1954 U.S. Code Cong. & Admin. News 4017, 4054, 4196, 4621, 4665, 4855.

Drew v. *United States*, 177 Ct. Cl. 458, 461, 367 F. 2d 828, 830 (1966). There is no reason to believe that under Arizona (or general) law Mr. Martin became liable for the taxes of Crystal, either directly as a transferee or mediately as a transferee of Coca-Cola Bottling (which has been authoritatively found to be a transferee). He was, of course, the sole owner of Crystal's stock, but he elected to operate his bottling business in corporate form, and could not thereafter disregard Crystal's separate legal entity to claim that he was the actual owner. *Cf. Higgins* v. *Smith*, 308 U.S. 473, 477 (1940). And it is a truism that neither the state nor the Federal Government would pierce the veil simply because he had been the owner of all of Crystal's stock. The tax obligations were solely those of Crystal, not of its stockholder as such or individually.

Moreover, plaintiff did not receive any of Crystal's assets on its liquidation; Coca-Cola Bottling was the sole distributee of that property. What Mr. Martin did was to divest himself of the ownership of Crystal's stock, leaving the new stockholder (Coca-Cola Bottling) to determine what to do with Crystal's assets. The new owner took the assets for itself. So far as this record shows, none went to Mr. Martin.

Arizona follows the accepted rule that where stockholders of a corporation receive its assets on liquidation and leave it without sufficient property to pay its creditors, then those stockholders are required to respond to creditors up to the full value of the assets received. *Drew* v. *United States, supra*, 177 Ct. Cl. at 461-62, 367 F. 2d at 830-31. That is why Coca-Cola Bottling, which received Crystal's stock and assets, was held liable as the latter's transferee. *Coca-Cola Bottling Co. of Tucson* v. *Commissioner, supra*, 334 F. 2d 875. But it is so well accepted as to go almost without saying that a mere creditor is not a transferee of property and is not so liable. To the extent, therefore, that Mr. Martin was a creditor who had not received

Crystal's assets he was clearly not responsible for Crystal's taxes.

In seeking to pin the label of transferee on Martin, plaintiffs stress the promissory note which he obtained for his Crystal stock and for which the Coca-Cola Bottling stock was pledged as security. The terms of this note are not in evidence, and plaintiffs have not shown that it gave Martin any greater rights than the normal pledgee. We must assume, then, that by virtue of this pledge he did not become the owner or controller of the Coca-Cola Bottling stock or of that company's property. He was not the dominant or controlling figure. Rather, he was merely a conventionally secured creditor of Bottling who had formerly owned Crystal's stock but no longer had control of that company or its assets. It follows that his status as a past stockholder of Crystal, his position as a present creditor of Bottling, and his holding of the promissory note did not deprive Crystal of any assets or transfer those assets to him from Coca-Cola Bottling. The creditors of Crystal were harmed by Coca-Cola Bottling's liquidation of Crystal and ingestion of its assets; they were not harmed by Martin's actions or by his mere creditor's relationship to the transferee corporation. *Cf. Vendig* v. *Commissioner,* 229 F. 2d 93, 94-96 (C.A. 2, 1956).

Nor did the indemnity agreement operate to make Mr. Martin a transferee. This promise was part of the consideration he provided for Coca-Cola Bottling's promissory note issued for the purchase of all of the Crystal stock. The agreement did not make Martin a stockholder or owner of Bottling or of Crystal, and it took nothing from either corporation. Also, as the Ninth Circuit said in *Coca-Cola Bottling Co. of Tucson, supra,* 334 F. 2d at 879: "We find no basis for interpreting Martin's promise as an assumption of any part of Crystal's debts or as an extension of a guarantee to Crystal's creditors that they would be paid."

Accordingly, we hold that the Martins have not been proved to have been transferees liable for the taxes im-

posed on Crystal, and that they could not deduct the legal fees and other expenses incident to the Tax Court proceeding against the true transferee, Coca-Cola Bottling. Those expenditures flowed solely from the contractual indemnity agreement and not from any transferee obligation of the Martins.

For these reasons, the plaintiffs are not entitled to recover and their petition is dismissed.

COLLINS, *Judge*, dissenting:

I would hold that plaintiff should be allowed to deduct under section 212(3) of the Internal Revenue Code of 1954 the legal expenses he incurred in contesting the determination of Crystal's tax deficiencies—deficiencies which, to the extent collected by the Government, diminished the plaintiff's own estate. By applying the holding of the *Davis*[1] case to the instant case, the court is unjustifiably extending that holding to a case controlled by wholly different factual circumstances.

In the first place, the statute clearly states that an individual may deduct "all the ordinary and necessary expenses paid * * * during the taxable year * * * in connection with the determination * * * of *any* tax." (Emphasis supplied.) The restriction imposed by the majority opinion, that the tax be one for which the individual is legally liable *to the Government*, appears nowhere in the statute. The legislative history is also devoid of any such restriction on deductibility. The applicable section of the House Report reads as follows:

> * * * A new provision added by your committee allows a deduction for expenses connected with determination, collection, or refund of *any* tax liability.[2] (Emphasis supplied.)

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[1] *United States* v. *Davis*, 370 U.S. 65, 74 (1962).

[2] H.R. REP. No. 1337, 83d Cong., 2d Sess. 29 (1954-3 U.S. CODE CONG. & AD. NEWS at 4054).

The detailed discussion of the bill provides, in part, as follows:

> Paragraph (3) is new and is designed to permit the deduction by an individual of legal and other expenses paid or incurred in connection with a contested tax liability, whether the contest be Federal, State, or municipal taxes, or whether the tax be income estate, gift, property, and so forth. *Any* expenses incurred in contesting *any* liability collected as a tax or as a part of the tax will be deductible.[3] (Emphasis supplied.)

The identical language is employed in the Senate Report.[4]

The gloss on the words of the statute emanated from the Supreme Court case of *United States* v. *Davis, supra.* However, nothing in the language or holding of that case would require that plaintiff be deprived of his deduction in the instant case. The *Davis* case involved a transfer of appreciated property by the taxpayer to his former wife pursuant to a property settlement agreement incorporated into a divorce decree. As part of the settlement, taxpayer agreed to pay his wife's legal expenses, which expenses included $2,500 for services concerning tax matters relative to the property settlement. The Supreme Court upheld the Court of Claims in holding that the $2,500 paid to the wife's attorney could not be deducted by the taxpayer. The reasoning of the Supreme Court is significant:

> * * * Here the fees paid her attorney do not appear to be "in connection with the determination, collection, or refund" of any tax of the taxpayer. As the Court of Claims found, the wife's attorney "considered the problems from the standpoint of his client alone. Cer-

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[3] H.R. Rep. No. 1337, 83d Cong., 2d Sess. A 59 (1954-3 U.S. Code Cong. & Ad. News at 4196).

[4] S. Rep. No. 1622, 83d Cong., 2d Sess. 34, 218 (1954-3 U.S. Code Cong. & Ad. News at 4665, 4855).

tainly then it cannot be said that * * * [his] advice was directed to plaintiff's tax problems * * *." 152 Ct. Cl., at 805, 287 F. 2d, at 171. We therefore conclude, as did the Court of Claims, that those fees were not a deductible item to the taxpayer.

370 U.S. at 74-75.

In short, the taxpayer had absolutely no connection with the tax to be paid by his wife, other than the fact that he paid the legal fees in connection with its determination. In other words, he merely agreed to pay the legal fees, *not the amount of the tax itself.* Whether his wife should subsequently be assessed a deficiency, or somehow even be granted a refund, was of no concern to the taxpayer. Under these circumstances the Court was certainly justified in finding that the tax being determined was in no way a tax of the taxpayer. The taxpayer was not legally liable for the amount of the tax *to the Government, to his wife, or to anyone.*

In contrast, in the instant case, plaintiff agreed that he would indemnify Gersten and Mayer and their new corporation for any taxes owed by Crystal for periods prior to the sale on November 1, 1955. The amount of any tax deficiency ultimately determined would become a personal liability of plaintiff, since he had obligated himself to pay it in the contract of sale. This is all that should be necessary for the application of section 212(3). The tax advice here was directed to plaintiff's problems, and any deficiency would ultimately result in a diminution of plaintiff's estate.[5]

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[5] In the Court of Claims opinion in the *Davis* case, one of the reasons given for denying the deduction was that the attorney's fees were not connected with the taxpayer's own estate.

In my opinion, the case of *Carpenter* v. *United States*, 168 Ct. Cl. 7, 338 F. 2d 366 (1964), is inapposite.

For these reasons, I believe that plaintiff is entitled to take his deductions of "*any* expenses incurred in contesting *any* liability collected as a tax or as a part of the tax" (emphasis supplied), as stated in both the Senate and House Reports, and "all the ordinary and necessary expenses paid or incurred during the taxable year * * * in connection with the determination, collection, or refund of any tax," as stated clearly in the statute. That statute does not make any exceptions to the deductions allowed.

Findings of Fact

The court, having considered the evidence, the report of Trial Commissioner Roald A. Hogenson, and the briefs and arguments of counsel, makes findings of fact as follows:

1. George Martin (who died after the institution of this action) and Peggy L. Martin were husband and wife, citizens of the United States and residents of Tucson, Arizona. The Southern Arizona Bank and Trust Company, and Mrs. Martin have been substituted as a party plaintiff in place of George Martin, but for convenience, he is sometimes referred to as the plaintiff.

2. For the calendar year 1961, the Martins filed their joint federal income tax return, in which they reported a taxable net income of $18,501.03 and an income tax liability of $4,758.35 which was paid by them within the time allowed by law. They kept their books and filed their federal income tax returns on the cash basis of accounting and by calendar years.

3. At all pertinent times prior to November 1, 1955, plaintiff owned and operated an Arizona corporation known as Crystal Coca Cola Bottling Company, hereinafter called Crystal, was president thereof, and owned all of its issued and outstanding capital stock (500 shares of common stock) held either in his name or in the names of his nominees. Crystal, engaged in the bottling business at Tucson, Ari-

zona, was plaintiff's principal source of income from 1951 until plaintiff sold his stock holdings therein in 1955.

4. Under date of July 23, 1955, plaintiff entered into an agreement to sell his stock in Crystal to Samuel A. Gersten and Lawrence D. Mayer, who were in the process of organizing an Arizona corporation to be known as Coca-Cola Bottling Company of Tucson, Inc., hereinafter called Coca-Cola Bottling, which would subsequently own and operate the business which had been conducted by Crystal.

The agreement, as amended October 26, 1955, provided that plaintiff would transfer to Coca-Cola Bottling on November 1, 1955, all of the outstanding shares of stock of Crystal in consideration of Coca-Cola Bottling's promissory note for $1,450,000, secured by a pledge of the shares of stock of both companies, with the understanding that Coca-Cola Bottling would have the right to liquidate and dissolve Crystal and to obtain a release of the pledge of the Crystal stock. Also included in the agreement, as amended, was the following provision:

> Seller [Martin] agrees to save, indemnify and hold harmless both the Buyer [Gersten and Mayer] and the said old [Crystal] and new [Coca-Cola Bottling] corporations against any and all claims for income taxes or any other kind of tax, interest and penalties claimed by or due to the United States or any state or municipality by the old corporation and, further, against any and all claims of any description or nature against the old corporation or against the real property and assets sold hereunder, arising from or by reason of any matters or thing occurring prior to the date of closing. Any such claim or liability paid by Buyer may, at Buyer's option, be either collected from Seller or deducted from payments due hereunder, PROVIDED, HOWEVER, Seller shall first have the right to contest, dispute and, if necessary, litigate any such claim, at Seller's sole expense, and in the name of the old company or the

new company, so long as the operation of the business and the interests of Buyer are not prejudiced or jeopardized thereby.

After its organization was completed, Coca-Cola Bottling ratified and adopted the agreement, and accepted the Crystal stock and issued its promissory note to plaintiff therefor. Effective November 1, 1955, Crystal's assets were transferred to the new corporation.

5. Prior to the negotiations between plaintiff and Messrs. Gersten and Mayer, plaintiff had executed on November 18, 1954, on behalf of Crystal, U.S. Treasury Department Form 872 (Consent Fixing Period of Limitation Upon Assessment of Income and Profits Tax), extending until June 30, 1956, the time in which the Internal Revenue Service might assess tax deficiencies against Crystal for its 1951 tax year. As a result of that consent, and also because of applicable statutory provisions, Crystal's federal income tax years 1951 through 1955 were open for possible assessments by the Internal Revenue Service when plaintiff sold his stock in Crystal to Messrs. Gersten and Mayer and their new corporation. Plaintiff advised Messrs. Gersten and Mayer of these facts at the time of their negotiations.

6. Plaintiff retired in 1955 after he sold his stock in Crystal. As of December 30, 1960, the principal balance still owing to plaintiff on Coca-Cola Bottling's $1,450,000 promissory note was $1,009,358.23.

7. Subsequent to the sale by plaintiff of his stock in Crystal, the Internal Revenue Service issued to Coca-Cola Bottling a statutory notice of transferee liability, asserting that Crystal owed income taxes and excess profits taxes in the amount of $117,057.46 for its tax years 1951 through 1955. This determination of deficiencies and transferee liability was contested in the name of Coca-Cola Bottling in the Tax Court of the United States. The parties filed a written agreement in such proceedings, specifying how the

amounts of the determined deficiencies and the amount of transferee liability would be adjusted and computed if Coca-Cola Bottling was held to be liable as transferee, but litigated the issue of transferee liability. After a hearing, the Tax Court decided that there were deficiencies in taxes due from Crystal and that Coca-Cola Bottling was liable for such taxes as transferee, with the total deficiencies determined to be due in the amount of $50,872.16. *Coca-Cola Bottling Co. of Tucson, Inc.* v. *Commissioner*, 37 T.C. 1006 (1962), *aff'd* 334 F. 2d 875 (9th Cir. 1964).

8. In connection with the prosecution of the cited case, plaintiff paid at various times during 1961 the following amounts to the following persons and firms for legal and accounting services, and for related printing and witness expenses:

Firm or Party	Nature of Services	Amount
Connor & Jones	Legal services	$11,287.89
Prince, Taylor & Crampton	Legal services	5,694.04
J. Mercer Johnson	Legal services	750.00
Lawton & Ford	Accounting services	5,193.49
Byron S. Adams	Printing costs	252.66
Travel expenses to interview a witness, and travel expenses of a witness, California to Tucson and return.	Witness costs	481.34
Total		$23,659.42

9. In connection with the preparation of an agreement amending the terms of a promissory note (in favor of plaintiff) which was executed by Coca-Cola Bottling, plaintiff paid John C. Haynes on January 30, 1961, $100 for legal services. This note was connected with the original sale of plaintiff's Crystal stock to Messrs. Gerston and Mayer.

At the trial of this case, plaintiffs conceded that this $100 item is not deductible as an expense and waived their claim as to that item.

10. In their joint federal income tax return for 1961, the Martins deducted the amount of $23,759.42 (representing the $23,659.42 and $100 amounts above-mentioned) as an expense deduction. After an examination of the return, the Internal Revenue Service determined that the amount of $23,759.42 was not a proper deduction and, under date of April 18, 1963, the Internal Revenue Service sent to the Martins (by certified mail) a statutory notice of deficiency in which that deduction was disallowed. After an adjustment for the gain to be reported, the Internal Revenue Service determined a deficiency in the amount of $10,651.02. This deficiency was paid on July 5, 1963, together with interest thereon in the amount of $756.08. On March 27, 1964, the Martins filed a claim for refund of the $10,651.02, plus interest thereon, based upon their contention that the deduction of $23,759.42 was erroneously disallowed. This claim was denied by the Internal Revenue Service on July 24, 1964, and Mr. and Mrs. Martin filed their petition herein on August 28, 1964.

Conclusion of Law

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that plaintiffs are not entitled to recover, and that plaintiffs' petition is dismissed.